

TEXAS REAL ESTATE COMMISSION

Austin, Texas

INTERNAL AUDIT REPORT

on

Cash Collection Fee Process/Remittance

Recovery Fund

Proprietary School Program Approval

Fiscal Year 2002

To the Audit Committee of the
Texas Real Estate Commission
Austin, Texas

We performed tests of management's assertion about the effectiveness of the internal control structure and compliance with its policies over the Cash Collection Fee Process/Remittance, Recovery Fund and the Proprietary School Program Approval processes for the year ending August 31, 2002. The results of our tests disclosed that such controls were generally adequate and no material instances of noncompliance were noted; however we noted certain matters that are opportunities for strengthening internal controls and compliance with contractual requirements. The report that accompanies this letter summarizes our comments and suggestions regarding the various processes reviewed.

We have discussed these comments and suggestions with Texas Real Estate Commission personnel, and we will be pleased to discuss it in detail at your convenience, to perform any additional study of these matters, or to assist you in implementing the recommendations.

Garza/Gonzalez and Associates

June 7, 2002

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INTRODUCTION

The Texas Real Estate Commission (the Commission), was created in 1939 under the Texas Real Estate Dealer's License Act and became an independent state agency in 1949. The Real Estate License Act (the Act) is the legislative authorization for the Agency to license and regulate real estate brokers and salespersons and provides for the licensing and regulation of real estate inspectors. The Commission also regulates residential service companies and easement or right-of-way agents. The Agency is responsible for administering and enforcing the provisions contained in the Act. Chapter 201, Texas Property Code, confers authority to the Agency to register by application and regulate entities offering timeshares in Texas.

The Texas Real Estate Commission is composed of nine Commissioners who are appointed by the Governor, with concurrence by the Senate, for six-year overlapping terms. Six members must be licensed real estate brokers who have been engaged in the real estate brokerage business as their major occupations for at least five years preceding their appointments. Three members must be members of the general public who are not licensed under the Act and do not have, other than as consumers, a financial interest in the practice of a real estate broker or salesman.

The Commissioners appoint an Administrator who serves as the Agency's chief administrative officer. The Agency's operating budget is prepared and approved by the Commission on an annual basis, whereas the State legislative appropriations are determined every two years. Appropriations are approved by the State Legislature. The Agency is divided into five divisions. The four operating divisions are the enforcement division, licensing and education division, information services division, and staff services division, all of which report directly to the Assistant Administrator. The Administration Division is headed by the Administrator and includes the Agency's general counsel.

The Agency is appropriated funds by the State for its operations. Revenues are primarily real estate license applications and renewals, education fees, and other charges derived from Agency operations. Funds collected by the Agency are not directly utilized in operations, but instead are passed on to the State.

Based on the 2002 internal audit plan we performed the following internal audits:

- Cash Collection Fee Process/Remittance
- Recovery Fund
- Proprietary School Program Approval

This report contains the results of our review of the above areas.

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In accordance with the **Standards for the Professional Practice of Internal Auditing**, the internal audits will encompass the examination and evaluation of the adequacy and effectiveness of the Commission's system of internal control and the quality of performance in carrying out assigned responsibilities. The audits will determine the following:

- **Reliability and Integrity of Information**
Internal auditors should review the reliability and integrity of financial and operating information and the means used to identify measure, classify, and report such information.
- **Compliance with Policies, Plan, Procedures, Laws, and Regulations**
Internal auditors should review the systems established to ensure compliance with those policies, plans, procedures, laws, and regulations, which could have a significant impact on operations and reports and determine whether the organization is in compliance.
- **Safeguarding of Assets**
Internal auditors should review the means of safeguarding assets and, as appropriate, verify the existence of such assets.
- **Economical and Efficient Use of Resources**
Internal auditors should appraise the economy and efficiency with which resources are employed.
- **Accomplishment of Established Objectives and Goals for Operations or Programs**
Internal auditors should review operations or programs to ascertain whether results are consistent with established objectives and goals and whether the operations or programs are being carried out as planned.

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EXECUTIVE SUMMARY

Background

Cash Collection Fee Process/Remittance

The Commission is the regulatory agency for real estate brokers and salespersons, real estate inspectors, education providers for real estate and inspection courses, residential service companies, timeshare developers and easement or right of way agents and as such collects licensing fees and charges for related services. The commission participates in Texas On-Line a state sponsored web-based service to provide access to licensees and prospective licensees for applications and renewal of licenses. All convenience fees will be eliminated after August 31, 2002. Instead a subscription fee will be applied to all renewal applications. The Commission has developed the new fee collection, remittance and reconciliation process.

The Cashier Department is comprised of a staff of 6 ½ employees: One (1) Supervisor Cashier, one (1) First Assistant Cashier, two (2) Assistant Cashiers, two (2) Mail Openers and a part time Mail Opener.

Following are the basic phases of the Cash Collection Fee Process:

- Processing regular and renewal mail- includes receiving, opening and separating regular and renewal mail.
- Registering regular and renewal mail- includes assigning register numbers, creating batches, separating payments, and preparing documents for department entry,
- Balancing batches and keeping logs
- Preparing deposits,
- Returning rejected checks
- Processing all walk-ins, and
- Processing and collecting returned checks
- Reconciling of on-line fees with licenses issued.

Recovery Funds (Real Estate and Inspection Funds)

The Real Estate Recovery fund was established on May 19, 1975 by an amendment to the Real Estate License Act. The Commission was directed to use the fund for reimbursing aggrieved persons who suffer monetary damages by reason of certain acts committed by a duly licensed real estate broker or salesperson, or by an unlicensed employee or agent of a broker or salesperson.

The Real Estate Inspection Recovery Fund provides remedy for consumers holding an unsatisfied judgment against a real estate inspector.

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A \$10.00 Recovery Fund fee is collected from each new applicant for a license in addition to the regular License filing fee. If at any time the balance remaining in the Real Estate Recovery Fund is less than \$1 million, each broker and salesperson will be required to pay an additional fee of \$10.00 or a pro rata share of the amount necessary to bring the Recovery Fund to \$1.7 million dollars, whichever is less. To ensure the availability of a sufficient amount to pay anticipated claims on the fund, the commission by rule may provide for the collection of assessments at different times and under different conditions other than those specified by this Act.

A Real Estate Inspection Recovery Fund fee of \$100 is collected prior to the issuance of an inspector's license. If at any time the balance remaining in the Real Estate Inspectors Recovery Fund is less than \$300,000, each inspector will be required to pay a fee of \$75, or a pro rata share of the amount necessary to bring the fund to \$450,000 whichever is less at the time of the next renewal. To ensure the availability of a sufficient amount to pay anticipated claims on the fund, the commission by rule may provide for the collection of assessments at different times and under different conditions other than those specified by this Act.

As set forth in the Real Estate License Act, as amended, the deposits to the Recovery Fund may be invested and reinvested in the same manner as funds of the Employee Retirement System of Texas. All investment transactions for both funds are conducted through the Texas State Treasury Operations of the Comptroller of Public Accounts.

The Administrative Division through the office of the General Counsel is responsible for undertaking legal review of recovery fund claims. The claims are reviewed to determine if all statutory requirements for payment appear to have been satisfied, provided the requirements have been met the claim may be submitted to the members of the Commission for consideration. The Attorney General of the State of Texas represents the Commission in opposition of any claims and is apprised of claims under review. The members of the Commission may authorize payment or instruct staff to oppose the claim.

Payments for each claim is limited to the aggregate of \$50,000; additionally claim payments for any one licensee or registrant is limited to \$100,000 from the Real Estate Recovery Fund. Similarly, for the inspection fund each claim is limited to the aggregate of \$12,500; additionally payments for any one licensed inspector may not exceed \$30,000 from the Real Estate Inspectors Recovery Fund.

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Proprietary School Program Approval Process

The Commission is authorized to accredit educational programs or courses of study in real estate and real estate inspection and to establish standards of accreditation for such programs conducted in the State of Texas. Colleges and universities accredited through their respective accrediting agency that provide real estate education are deemed to have met the Commissions standards based on that accreditation. The rules that apply to the accreditation and approval of courses do not apply to colleges and universities. Additionally, The Commission performs the approval of instructors of real estate and real estate inspection course subject matter areas. For approval the person must satisfy the Commission of the competency in the subject matter to be taught and the ability to teach the subject effectively. Additionally, each instructor must meet certain educational, industry and teaching experience requirements.

Courses of study required for a license may include, but are not limited to the following which are considered core real estate courses:

- Principles of Real Estate,
- Real Estate Appraisal,
- Real Estate Law,
- Real Estate Finance,
- Real Estate Marketing,
- Real Estate Mathematics,
- Real Estate Brokerage,
- Property Management,
- Real Estate Investments,
- Law of Agency, and
- Law of Contracts.

The Commission also regulates the provision of Mandatory Continuing Education (MCE). A person who wishes to offer courses accepted by the commission for MCE credit shall apply to the Commission for approval to be an MCE provider and for approval of each MCE course using application forms prepared by the Commission. Each prospective provider shall submit a provider application and at least one "principal information" form. Instructors are approved by the commission for particular subject areas and may only teach courses in that subject matter area for core real estate and inspection and MCE courses. MCE course approval expires 2 years from the date the provider is approved by the commission except for courses approved as single course offerings.

The Education Section is supervised by the Assistant Administrator and is comprised of six (6) staff: One (1) Education Manager, three (3) Education Specialists, one (1) Education Evaluation Specialists, and one (1) receptionist. In addition to the accreditation of core and MCE providers, approval of courses and instructors the Education Section determines that education requirements are satisfied for original and renewal applications, processes record changes and prepares education histories of licenses.

I. External Quality Assurance Review

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The internal audit department received a peer review in August 2000. The peer review resulted in an unqualified opinion.

II. High Level Audit Objectives

Cash Collection Fee Process / Remittance

The objective of our audit was to gain an understanding of the Cash Collection Fee process and controls to determine if:

- The Commission is in compliance with applicable internal policies and procedures,
- The reports and schedules generated adequately support the processes and controls in place, and
- The processes and/or controls have been implemented and are functioning as designed,

The procedures performed to achieve the objectives of our audit were as follows:

- a) Obtained and reviewed the Commissions internal policies, procedures, and current practices to ensure the fees and payments received are properly applied, accounted for and controlled.
- b) Selected register numbers from regular and renewal mail to be tested. Tested the selected transactions to assure that the receipts are adequately safeguarded, properly applied and that documented controls and practices are implemented and consistently applied.
- c) Performed an observation of the cash collection process to determine that documented control activities were performed.
- d) Reviewed and documented the procedures performed in the Texas On-line reconciliation process and the proposed changes based on the new fee remittance process.

Recovery Funds

The objective of our audit was to obtain an understanding of the Recovery Funds' process and the controls in place to determine if:

- The Commission is in compliance with the applicable provisions of the Real Estate Licensing Act, the Rules of the Commission and the internal policies, procedures and practices in the performance of the Recovery Fund process.
- The Commission is applying the laws, policies, procedures, practices and applicable established internal controls in the processing of applications for the recovery of funds from injured parties.
- The Commission adequately tracks the activity and balances of the recovery fund to determine compliance with applicable laws and rules.

The procedures performed to achieve the objectives of our audit are as follows:

- a) Obtained and reviewed the applicable provisions of the Real Estate License Act and the Rules of the Real Estate Commission.
- b) Performed interviews with the General Counsel and Director of Staff Services to obtain an understanding of the process and related activities.
- c) Tested selected applications for recovery from the current fiscal year to determine that the laws,

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- rules and internal practices and procedures were applied.
- d) Obtained and reviewed the reports of balances and activity of the recovery funds to determine consistency with applicable laws and regulations.

Proprietary School Program Approval Process

The objective of our audit was to gain an understanding of the Proprietary School Program Approval Process and controls to determine if:

- The Commission is in compliance with, the Provisions of the Real Estate Licensing Act, the Rules of the Texas Real Estate Commission and the applicable internal policies and procedures established to perform the approval process.
- The processes and/or controls have been implemented and are functioning as designed to assure that only schools, courses and instructors that meet the rules and regulations are approved.

The procedures performed to achieve the objectives of our audit are as follows:

- a) Obtained and reviewed the Provisions of the Real Estate Licensing Act, the Rules of the Texas Real Estate Commission applicable to the approval process.
- b) Obtained available documentation and conducted interviews to document formal/informal processes and controls.
- c) We selected samples from the population of Proprietary Schools, MCE Providers, Instructors, Core Courses and MCE Courses to determine that the applicable laws, rules, policies and procedures were applied in processing the approval of the applicant.

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III. List of Audits Completed by High Level Audit Objectives

Report No.	Report Date	Name of Report	High Level Audit Objectives				
			Financial (and other) Reporting	Effectiveness and Efficiency	Compliance with Policies, Laws and Regulations	Safeguarding of Assets	Accomplishment of Objectives and Goals
1	6/7/2002	Cash Collection Fee Process/ Remittance	X		X	X	X
1	6/7/2002	Recovery Fund	X	X	X	X	X
1	6/7/2002	Proprietary School Program Approval		X	X		X

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Report No.	Report Date	Name of Report	Observations/ Findings/Recommendations	Status (Implemented, Planned, In Progress, Factors Delay Implementation, Agency Does Not Plan to Implement Recommendation)	Fiscal Impact/Other Impact
1	6/7/02	Annual Audit Report	<p>Proprietary Program Approval Process</p> <p>1. The Education Section performs the approval process for Proprietary Schools, Instructors and Courses. The rules and regulations for the approval of the applicants are generally followed; however, not all requirements for approval have been fully documented. Even though a review checklist has been developed, it is not consistently utilized but during our review we noted instances of non-compliance with the rules and regulations as follows:</p> <ul style="list-style-type: none"> For one (1) of the five (5) proprietary school applications reviewed, we noted the use of an independent contractor on the application, however the Commission Form ED 20 for that contractor was not included in the application as required. A requirement for the approval of a proprietary school is the submittal of annual updates for core course examinations. For one (1) of the five (5) proprietary school applications reviewed there was no indication that the annual examination updates were submitted. One (1) of the five (5) applicants for instructor reviewed did not provide evidence of the required education, experience or demonstrate three years of teaching experience. <p>Recommendation We recommend that the Commission develop and formally adopt a comprehensive checklist addressing all rules and regulations required to approve Proprietary Schools, instructors and Course. In addition, we recommend consistent use of the checklist for all applicants.</p>		Internal Control over the Proprietary Program Approval Process.

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Report No.	Report Date	Name of Report	Observations/ Findings/Recommendations	Status (Implemented, Planned, In Progress, Factors Delay Implementation, Agency Does Not Plan to Implement Recommendation)	Fiscal Impact/Other Impact
			<p>Management's Response</p> <p>When the proprietary school application for re-approval was received a narrative was included within the application papers submitted regarding financial issues. The narrative contained a short sentence stating that the independent contractor would pay the proprietary school either \$250 or \$300 per class. When the application was reviewed, this sentence was overlooked and staff did not request a principal application for the independent contractor. Since that time Education staff has received a principal application form from the independent contractor.</p> <p>A system is in place that captures information that can be used to track examination updates for Core courses. We will request a report from Information Services that will list the proprietary schools who have not submitted annual revised examinations. This list can be used by staff to notify those schools who have not submitted revisions.</p> <p>The instructor applicant in question was approved by staff during the transition period between Manager assignments in June of 2000. The instructor applicant requested approval to teach Core courses. At the time, she had 4 years professional experience for the requested subject areas. As of this date, she has been licensed the minimum 5 years as a real estate salesperson and is now qualified. Upon contacting her, she indicates in writing that she has not taught the Core courses she originally sought approval to teach and has submitted a letter to the Education staff to that effect. Since September 2000 instructor applicants are reviewed and approved by the Education Manager, and Education staff have used checklists to ensure that only individuals with the required experience are given authority to teach.</p> <p>Comprehensive checklists addressing rules and regulations required to approve MCE and Proprietary Schools, Instructors, and courses have been developed and in use since December 2000. Management will ensure that these forms are consistently used.</p>		

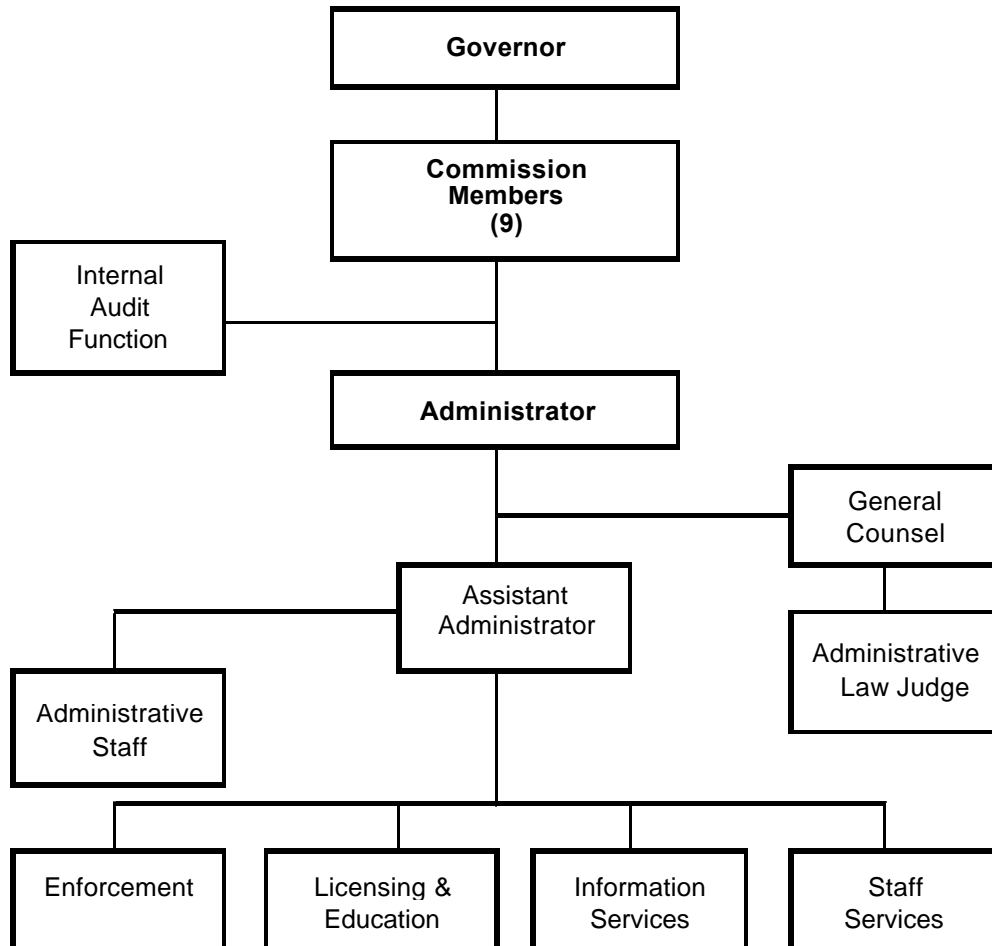
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IV. Organizational Chart



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V. Report on Other Internal Audit Activities

There were no additional areas assigned by the Texas Real Estate Commission.

VI. Proposed Internal Audit Plan for Fiscal Year 2003

- Compliance with the Public Funds Investment Act
- Education Program Monitoring
- Performance Measures
- HUB - Compliance